BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF CALIFORNIA

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In the Matter of the Application of California-American Water Company (U 210 W) for an Order Authorizing it to Increase its Rates for Water Service in its Los Angeles District to Increase Revenues by $2,020,466 or 10.88% in the Year 2007; $634,659 or 3.08% in the Year 2008; and $666,422 or 3.14% in the Year 2009.	)	Application 06-01-005 (Filed January 9, 2006)

MOTION OF CALIFORNIA WATER ASSOCIATION FOR PARTY STATUS

In accordance with Rule 1.4 of the Commission's Rules of Practice and Procedure, California Water Association ("CWA") hereby submits its Motion for Party Status in the above-captioned proceeding. CWA respectfully submits this Motion for purposes of filing comments on the proposed decision of Administrative Law Judge ("ALJ") Walwyn ("PD"), entitled "Opinion Adopting the Revenue Requirement for California-American Water Company (Los Angeles District)," which was released for comment on May 7, 2007. A copy of the "Comments of California Water Association on Proposed Decision of ALJ Walwyn" is appended to this Motion as Attachment A.

In support of this Motion for Party Status, CWA provides the following information:

CWA is a trade association comprised of many of the investor-owned water utilities regulated by this Commission, including seven of the ten Class A water utilities subject to Commission jurisdiction. CWA regularly represents the investor-owned water utility industry before the Commission and the California Legislature on matters of common interest to the industry. It has appeared on many occasions and in many proceedings before the Commission.

Among the proceedings in which it is an active party is I.07-01-022, an "Investigation to Consider Policies to Achieve the Commission's Conservation Objectives for Class A Water Utilities" (the "Water Conservation Proceeding") and the four applications that have been consolidated with the Conservation Proceeding. Among the subjects to be considered in the Water Conservation Proceeding is the relationship between the adoption of a water revenue adjustment mechanism ("WRAM") for an individual water utility and the utility's return on equity. The PD in this proceeding proposes to determine that relationship for California American Water Company. On behalf of its Class A water utility members, CWA seeks party status in this proceeding to address whether the relationship between a WRAM and a utility's return on equity should be more appropriately handled in a generic proceeding, such as the Water Conservation Proceeding, in subsequent cost of capital proceedings, or in this immediate GRC. Thus, CWA's proposed participation in this proceeding is pertinent to issues already before the Commission in this and related proceedings.

For all of the foregoing reasons, CWA urges the Commission to grant this Motion for Party Status and to accept CWA's comments on the PD appended hereto as Attachment A.

DATED: May 29, 2007

Respectfully submitted,

NOSSAMAN, GUTHNER, KNOX & ELLIOTT LLP

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ATTACHMENT A

BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF CALIFORNIA

In the Matter of the Application of California-American Water Company (U 210 W) for an Order Authorizing it to Increase its Rates for Water Service in its Los Angeles District to Increase Revenues by $2,020,466 or 10.88% in the Year 2007; $634,659 or 3.08% in the Year 2008; and $666,422 or 3.14% in the Year 2009.	)	Application 06-01-005 (Filed January 9, 2006)

COMMENTS OF CALIFORNIA WATER ASSOCIATION ON PROPOSED DECISION OF ALJ WALWYN

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COMMENTS OF CALIFORNIA WATER ASSOCIATION ON PROPOSED DECISION OF ALJ WALWYN

In accordance with Rule 14.3 of the Commission's Rules of Practice and Procedure ("Rules"), California Water Association ("CWA") hereby submits its comments on the proposed decision of Administrative Law Judge ("ALJ") Walwyn, titled "Opinion Adopting the Revenue Requirement for California-American Water Company (Los Angeles District)" ("Proposed Decision" or "PD"), which was released for comment on May 7, 2007. CWA respectfully submits these comments subject to its concurrently filed motion to become a party to this proceeding, pursuant to Rule 1.4 of the Commission's Rules.

I.
CWA'S INTEREST IN THE PROPOSED DECISION

As an industry association representing the interests of investor-owned water utilities that are subject to regulation by the Commission, CWA seeks to promote the adoption of sound water policies by the Commission and the California Legislature. In that role, CWA is participating actively in the Commission's ongoing investigation of policies to achieve

conservation objectives for Class A water utilities,[1] in which the parties and the Commission are considering the development of conservation-oriented rate design and the adoption of balancing account procedures, such as a Water Revenue Adjustment Mechanism ("WRAM"). Among the issues presented in the Commission's order instituting the water conservation investigation is whether the utilities' required return on equity should be adjusted if a WRAM is adopted. I.07-01-022, at 9.

In the context of the present general rate case ("GRC") for California American Water Company ("California American"), the proposals of California American for a conservation rate design and a WRAM have yet to be considered. However, the Proposed Decision of ALJ Walwyn includes an assessment of the impact that adoption of a WRAM would have on California American's business risk and on the appropriate level of the company's authorized rate of return on equity ("ROE"). The PD would impose a 50 basis point (0.50%) downward adjustment of California American's ROE, in the event that the Commission adopts a WRAM and a Modified Cost Balancing Account ("MCBA") for California American in Phase 2 of the current GRC.

The imposition of an ROE adjustment based on authorization of a WRAM, as the PD proposes in the present GRC, would preempt the consideration of that issue on an industry-wide basis in the Conservation OII and would bias that proceeding. At worst, it may predetermine the result of that consideration. It also puts the cart before the horse – arbitrarily determining the precise impact on ROE of a ratemaking mechanism that has not yet been defined in detail, let alone placed into operation. Accordingly, in its role as representative of the business interests of its members in promoting sound water policies, CWA is very directly affected by the PD's

[1] *Order Instituting Investigation to Consider Policies to Achieve the Commission's Conservation Objectives for Class A Water Utilities*, I.07-01-022, adopted January 11, 2007 ("Water Conservation OII").

proposal to impose a downward adjustment in ROE on California American. This is why CWA is filing its concurrent motion for party status in this GRC and submitting these comments.

II.

THE PROPOSED DECISION ERRS IN PREJUDGING THE RETURN ON EQUITY IMPACT OF ADOPTING A WRAM AND AN MCBA.

The Proposed Decision defers to Phase 2 of the California American GRC the determination of rate design and of whether to adopt a WRAM and/or an MCBA. However, in anticipation that the WRAM and MCBA may be adopted, the PD determines that "there should be a concurrent .50% reduction in ROE." PD, at 2-3.

The PD notes DRA's contention that addition of WRAM and MCBA mechanisms "would remove virtually all Cal-Am's business risk," which was the basis for DRA's recommendation of a severe ROE reduction to accompany adoption of those mechanisms. PD, at 32. The PD contrasts DRA's reliance on prior Commission decisions addressing the financial effects of similar adjustment mechanisms approved for energy utilities with the testimony of California American's expert that past decisions do not support an adjustment to ROE when implementing revenue adjustment mechanisms. PD, at 33. ALJ Walwyn sides with DRA, finding that the Commission "has consistently held that the adoption of revenue adjustment mechanisms . . . reduces business risk" and, in implementing these mechanisms, has "explicitly reflected this risk reduction in each utility's adopted ROE." PD, at 34.

To support this "finding," the PD refers to statements about risk reduction in a series of Commission decisions, beginning with a 1978 decision authorizing the first gas supply adjustment mechanism ("SAM"), including 1981 and 1982 decisions authorizing an electric revenue adjustment mechanism ("ERAM") for PG&E, SDG&E, and Southern California Edison, and continuing through a 1990 decision allowing a temporary WRAM for water utilities in the

context of the *Drought OII*.[2] PD, at 34-38. Based on this case law, the PD concludes that the Commission should make a downward adjustment to ROE to reflect reduced business risk if a WRAM and MCBA are adopted for Cal-Am. PD, at 38. Based on "informed judgment," the PD would set that adjustment at 0.50%. *See*, PD, at 39-40.

DRA's initial showing on this issue was minimal and was easily rebutted by California American. ALJ Walwyn, however, required both parties to submit supplemental testimony and extended the evidentiary hearing to consider these supplemental showings. This resulted in consideration of the impact of WRAM on ROE as an afterthought to the in-depth cost-of-capital analysis that was conducted in the same proceeding.

As will be explained in these comments, the PD's determination to impose an ROE reduction in anticipation of the adoption of a WRAM and/or an MCBA is erroneous for several reasons. First, the PD ignores the context in which these new ratemaking mechanisms are being considered – the adoption of a conservation rate design that ***increases*** the utility's risk. A WRAM that decouples sales from revenues is intended to reduce the level of risk associated with the loss of revenues as a direct result of the conservation methods employed and results achieved. Any reduction in the overall level of business risk that existed prior to implementation of the WRAM is incidental, if it occurs at all – and will benefit ratepayers and shareholders equally. Accordingly, no adjustment in ROE is necessary or warranted.

Second, the Commission's Water Action Plan offers "an opportunity for higher earnings resulting from successful conservation efforts, and a sharing of savings with customers." Water Action Plan, adopted December 15, 2005, at 10. In this context, a utility that adopts a rate design to encourage conservation and protect valuable water resources should be

[2] *Re Measures to Mitigate the Effects of Drought on Regulated Water Utilities, Their Customers and the General Public*, D.90-08-055, 37 CPUC 2d 196 (1990).

allowed to implement measures that mitigate the associated risk, without reducing its current authorized ROE. It is unreasonable and counterproductive for the Commission's first response to a utility's proposal to implement Water Action Plan priorities to be effectively punitive in nature.

Third, the PD misinterprets a long line of past Commission decisions that have recognized that adoption of a revenue adjustment mechanism may reduce equity risk but have ***not*** imposed an explicit ROE reduction on that account. The PD is inconsistent with these past decisions in imposing an ROE reduction based solely on the prospective adoption of a WRAM and/or an MCBA.

Finally, the PD adopts an ROE adjustment without even knowing the specific form of a WRAM and/or an MCBA – or the specific conservation rate design – that may be adopted for California American. Without knowledge of these "details," it is premature to be adopting such an adjustment – even if such an adjustment were warranted on analytical or policy grounds, which it is not.

As CWA will show, the issue of whether ROE should be adjusted upon the adoption of a WRAM already is pending consideration, on an industry-wide basis, in the Water Conservation OII. The current PD should not preempt determination of that issue. The proper venue for considering levels of rate of return and ROE will be the company-specific applications in the new, consolidated Cost of Capital proceedings for which the Commission has provided in the just-completed Class A water utilities' Rate Case Plan, adopted May 24, 2007, in D.07-05-062. The new Cost of Capital proceedings will review each company's ROE in the context of ***all*** the changes implemented pursuant to the Water Conservation OII.

A. The PD Misunderstands the Implications of the Commission's Past Decisions Authorizing Revenue Adjustment Mechanisms.

The PD misreads important aspects of the Commission's decisions authorizing revenue adjustment mechanisms and setting ROEs in the context of those mechanisms. CWA will review those decisions in detail in order to set the record straight.

As noted above, ALJ Walwyn finds that the Commission "has consistently held that the adoption of revenue adjustment mechanisms . . . reduces business risk" and, in implementing these mechanisms has "explicitly reflected this risk reduction in each utility's adopted ROE." PD, at 34. The first part of this finding is factual, but the latter part is not.

No gas or electric case has been identified in which the Commission has identified an explicit ROE adjustment based on the adoption or maintenance of a revenue adjustment mechanism. In fact, in each of the energy utility cases on which ALJ Walwyn relies, ROE was trending upward, not down, and the adoption of a revenue adjustment mechanism was simply one consideration mentioned among a variety of other factors; it never was assigned a quantitative weight or effect.

The first relevant decision was the Commission's 1978 order establishing a supply adjustment mechanism ("SAM**"**) to provide natural gas utilities the opportunity to recover the test year level of gas margin in a period of skyrocketing energy costs and scarcity of fossil fuels. *See*, D.88835, 1978 Cal. PUC Lexis 62; 84 CPUC 5, adopted May 16, 1978. In that decision, the Commission recognized a linkage between a SAM and the previously adopted inverted block rate structure, which had substantially ***increased*** gas utilities' business risk. The Commission viewed the SAM as "a logical concomitant of our policy of inverted rates," recognizing that

> supply (or more correctly, sales) volume has become at once (1) a factor of extraordinary impact on the gas margin as well as (2) an element of ratemaking that cannot be quantitatively predicted with the precision required to assure that a utility neither grossly exceeds nor falls far short of its

> authorized gas margin. In short, like the purchased *cost* of gas, supply fluctuation must be accorded special treatment between general rate proceedings.

1978 Cal. PUC Lexis 62, at *12 (emphasis in original).

The Commission expressly rejected the argument that "adoption of a SAM will constitute a step in the direction of a guaranteed rate of return," observing instead,

> a SAM will merely insure that gas utilities achieve the gas margin last found necessary and *limit* the utility to that margin. Utility expenses *other* than the purchased cost of gas can and will change between general rate proceedings and those changes will determine whether the gas margin maintained by a SAM will actually produce a rate of return that meets or exceeds the utility's authorized rate of return. . . . A SAM will thus not guarantee a rate of return but only insure that a utility's exceeding or failing to meet that return will not be the result of extraordinary and unpredictable fluctuations in sales or supply.

Id. at *13-14 (emphasis in original).

In approving implementation of a SAM by California's gas utilities, the Commission recognized that adopting a SAM would reduce risk to the utility shareholder, but the Commission made no attempt to quantify that reduction. Instead, the Commission deferred the issue as one to be considered "in setting a reasonable rate of return in future general rate proceedings as well as those currently pending before the Commission." *Id.* at *14.

In that next round of GRCs, the Commission kept the authorization of SAMs in mind, but still did not assign any specific value to them. In *Pacific Gas and Electric Co*., D.89316, 1978 Cal. PUC Lexis 973; 84 CPUC 248, adopted September 6, 1978, the Commission stated,

> In determining a fair return on common equity for these proceedings, we have considered the impact on risk derived from our adoption of Rate Stabilization and Energy Cost Adjustment Clause (ECAC) procedures for PG&E's electric department and the SAM and Purchased Gas Cost Adjustment Clause (PGA) for the gas department. We have also considered the fact that the Regulatory Lag Plan (applied to PG&E for the first time in these proceedings) worked extremely well.
>
> These measures are designed to better allow PG&E to maintain a reasonably constant cash flow between general rate proceedings. These measures,

> however, must be viewed in the context of recent increases in inflation and upward trends in interest rates. But for these measures, it is likely that a higher return on common equity might be warranted to insure the financial health of the utility. Although, as mentioned, our innovative ratemaking measures impact risk downward, we do not find that in the balance (weighed against rising debt cost) a reduction in allowed return on equity is warranted.

Id. at *27-28. Accordingly, the Commission maintained PG&E's authorized ROE at 12.83%.

In its first review of rates for Southwest Gas Co. (a company comparable in size to several Class A water utilities) following allowance of a SAM, the Commission noted staff's recommendation that ROE be reduced from 13.3% to 12.97%, based on several considerations including the allowance of a SAM. *Southwest Gas Co*., D.89706, 1978 Cal. PUC Lexis 1510, at *10, 84 CPUC 634, adopted December 12, 1978. Having "carefully considered all of the above-listed factors (including the effect of SAM)," the Commission concluded that the last authorized return on equity of 13.3% should be maintained. The Commission explained this determination as follows:

> Our adoption of a 13.3 percent return on equity is made in recognition that, as the staff points out, there are factors since we originally adopted that return (in SW's last rate proceeding) which very arguably reduce risk. However, we stress, on the other hand, that the 13.3 percent rate on equity authorized herein is made with recognition that the next test year we will use to set rates for SW will be 1981. . . . Accordingly, we are authorizing the rates herein (through adoption of a results of operation and return on equity rate base) conditional upon employing 1981 as the next earliest test year for establishing SW's base rates (and issuing a rate decision prior to the beginning of such test year).
>
> . . . Although SAM does not guarantee a gas utility will realize its authorized rate of return, it minimizes the impact of the most volatile contingencies facing a gas utility, gas supply available for sale, and less use per customer due to conservation efforts.
>
> The factors that may operate between general rate proceedings in such a manner as to preclude SW's realizing its authorized return on equity are expenditures subject to its management's review and discretion. The innovative ratemaking procedures we have adopted, and continue to explore, have clearly paved the way to going a minimum of two years between general rate increases.

Id. at *12-14; *see also*, *Southern California Gas Co.*, D.89710, 1978 Cal. PUC Lexis 1506, *38-40; 84 CPUC 657, adopted December 12, 1978 (granting a 13.49% ROE with similar language). Thus, the Commission took the allowance of a SAM into account along with the effect of a two-year GRC cycle, and concluded that ROEs should be maintained or increased.

This string of gas utility decisions implementing the SAM and setting ROEs in the context of the SAM among other factors has clear implications for water utilities. If a two-year GRC cycle for Southwest Gas and SoCal Gas cancelled out the risk mitigation of a SAM, then the ever more rigorous three-year GRC cycle to which Class A water utilities are subject may justify the same response to the WRAM. More generally, it is clear that imposing a quantified, "explicit" ROE reduction based on the allowance of a WRAM, but without comparable ROE increases based on countervailing factors, would be inappropriate and cannot be justified by relevant precedent.

The next round of energy utility GRCs featured the Commission's approval of a similar revenue adjustment mechanism for electric rates, called the Electric Revenue Adjustment Mechanism ("ERAM"). As will be evident, these cases provide no better support for the explicit ROE reduction mandated by the PD.

The Commission explained the value of the ERAM in a PG&E decision:

> It will reduce the time devoted to the issue of appropriate sales estimate levels to be used for ratemaking. It is especially difficult in this period to make accurate sales estimates because of the state of the economy and the inability to accurately quantify the effects of conservation which we are expecting our utilities to promote even more vigorously in the future. Furthermore, the adoption of an ERAM at this time will eliminate any disincentives PG&E may have to promote vigorous conservation measures and also be fair to ratepayers in assuring that PG&E receives no more or no less than the level of revenues intended to be earned.

Pacific Gas and Electric Co., D.93887, 1981 Cal. PUC Lexis 1279, *86, 7 CPUC2d 349, adopted December 30, 1981. In the same decision, the Commission granted PG&E its highest

ever ROE of 16.0%, based on a number of financial considerations, while observing – without any quantification – that "additional cash flow resulting from the Tax Act as well as the revenue stability from the Energy Revenue Adjustment Mechanism (ERAM) adopted herein should reduce PG&E's risk and thus the size of the return." *Id.* at *14.[3]

In a decision issued the same day, approving an ERAM for SDG&E, the Commission addressed the risk implications as follows:

> Related to the question of risk reduction for the utility, we note that this decision provides for a revenue adjustment mechanism which protects SDG&E from any reduction in electric sales below the adopted figures. Conversely, if sales are above the adopted figures, the ratepayers will receive a refund. This mechanism is described in the results of operations section. We might mention there is a similar mechanism already in place for gas sales and this has insulated SDG&E from the effects of reduction in gas sales.

San Diego Gas & Electric Co., D.93892, 1981 Cal. PUC Lexis 1284; 7 CPUC2d 584, adopted December 30, 1981.

In the SDG&E decision, the Commission did not try to quantify the risk reduction benefits of SAM and ERAM. Rather, the Commission's attention was directed to the viability of SDG&E as an investment choice. The Commission observed that "since all utilities have to compete in the same marketplace as industrials, the rates of return must adequately reflect market conditions." Accordingly, the Commission adopted a historically high 16.25% return on common equity as reasonable for SDG&E. *Id.* at *39-40.

The last in this series of decisions on which the PD relies was *Southern California Edison Co.*, D.82-12-055, 1982 Cal. PUC LEXIS 1209, 10 CPUC2d 155, adopted December 13, 1982. In that decision, the Commission noted several parties' opposition to the ERAM concept

[3] Elsewhere in the decision, the Commission observed that "the Tax Act has legislatively provided PG&E with a substantial increase in cash flow. Our adopted rate of return on rate base and return on common equity gives consideration to this increase in cash flow as well as the adoption of ERAM and attrition adjustment procedures." Id. at *82. The PD, at 35, quotes only the second sentence above, thereby obscuring the fact that the Commission considered PG&E's cash flow benefits under the Tax Reform Act of 1981 along with ERAM and a new attrition allowance, and still ***increased*** PG&E's ROE to a level never seen before or since that date.

on the basis that it would detract from conservation efforts and shift a stockholder's risk to the ratepayers, but expressed the opinion that "any such effects are more than offset by the advantages that accrue to the ratepayer and stockholder alike." *Id.* at *30-31.

In addressing ROE in this Edison case, the Commission expressed the following considerations:

> The determination of a reasonable return on equity is necessarily a matter of judgment and cannot be reduced to a fixed formula. Each case must be decided after considering many variables, such as the cost of money, the capital structure of the utility in comparison with similar utilities, and interest coverage ratios. In addition, risk factors specific to the utility must be considered. We have provided for an electric revenue adjustment mechanism. This mechanism reduces the risk to the company that its earnings may be eroded by a reduction in electric sales below the adopted sales levels. We have also provided an attrition allowance which will provide Edison a reasonable opportunity to earn the authorized rate of return in attrition year 1984.
>
> We take cognizance of the decline in interest rates which has occurred since the submission of this proceeding. There is now little indication that interest rates will approach levels during 1983 which were forecasted during the hearing process. In light of this factor, Edison's cost of financing should be lower than Edison originally anticipated.
>
> After weighing all of the above factors, we find that a return on common equity of 16% is just and reasonable.

Id. at *233-34. In other words, having approved an ERAM and an attrition allowance for Edison and observing a decline in interest rates, the Commission still granted Edison a 16.0% ROE, the highest ever authorized for that utility.[4]

ALJ Walwyn concedes that the most recent energy cases in which the Commission authorized revenue adjustment mechanisms – during the electric power crisis of 2000 to 2002 – do not support her thesis that automatic ROE adjustments must follow. The PD notes that

[4] In presenting DRA's reference to the Edison ERAM decision, the PD makes the same error as DRA in providing only a partial quote of the Commission's assessment that ERAM provides the utility "a better opportunity to earn its authorized rate of return" but also protects the ratepayer by insuring "that the utility retains no more than the authorized amount of base rate revenue." Both DRA and the PD misleadingly omit the latter portion of the relevant decision excerpt. *Compare*, PD, at 33, *with* D.82-12-055, at 1.

revenue balancing accounts were reinstituted at that time pursuant to the Legislature's enactment of ABX1-29. PD, at 34 n. 38. However, there was no provision either in that statute (codified as Public Utilities Code §739.10) or in the Commission's implementing decision, D.02-04-055, imposing any impediment upon the Commission's power to adjust electric utility ROEs in response to the reestablishment of ERAM accounts. The Commission simply chose not to do so.

Finally, the PD looks to the Commission's authorization of sales loss memorandum accounts and revenue adjustment mechanisms for water utilities, in the context of the 1990 *Drought OII* decision, D.90-08-055, and the subsequent imposition of a 0.2% ROE reduction as precedent for imposing an explicit percentage reduction in ROE. *See*, PD, at 37-38, *citing* D.91-10-042. In this context, the PD asserts that California Water Service Co. ("CWS") calculated a 1.23% reduction in ROE for purposes of interim recovery and a 0.51% factor for a permanent ROE reduction and "initially offered" to accept such a "risk adjustment." PD, at 38, 40. This partial rendition of the facts is seriously misleading.

What the PD overlooks is that CWS submitted testimony in the Drought OII contending that "it is inappropriate to single out the narrow issue of reduced risk associated with the recovery of drought-related lost revenues" in the assessment of financial risks for water utilities. Testimony of CWS, Phase II Risk Assessment, I.89-03-055, dated April 29, 1991, at 1. CWS also opposed any ROE adjustment for reduced risk due to recovery of lost revenue because the utility's previously authorized return did not contain any specific allowance for such risk. *Id.* at 3. The 1.23% and 0.51% calculations CWS offered in that case were quantifications of drought-related loss of ROE due to water rationing. Contrary to the PD's inference, CWS ***opposed*** reflecting these calculations in its authorized ROE. *Id.* at 5-6.

These are the cases on which the PD relies for its finding that, in implementing revenue adjustment mechanisms, the Commission has "explicitly" reflected a reduced business

risk in each utility's adopted ROE. PD, at 34. These are the cases that the PD sees as calling for a downward adjustment to ROE to reflect reduced business risk if a WRAM is adopted for California American in the next phase of the current GRC. *Id.* at 38. However, as must be clear from the more thorough references provided above, in only one of these cases – the *Drought OII* – did the Commission identify a specific adjustment to ROE (just 0.2%) based on implementation of a revenue adjustment mechanism – and in all other cases the Commission has considered the SAM or ERAM only as ***one factor among many*** that is relevant to the determination of ROE.

B. The PD Errs in Considering the Impact of a WRAM on Cost of Equity in Isolation From Conservation Efforts, Including Conservation Rate Design.

Authorization and implementation of a WRAM does not occur in isolation. To the contrary, the Commission has encouraged water utilities to request WRAMs in the general context of the Commission's increased emphasis on promoting water and energy conservation and in the specific context of the Commission's promotion of conservation-oriented rate design. *See*, Water Conservation OII, *supra*, at 3-6.

It is unreasonable to impose an ROE adjustment reflecting the increased revenue stability that a WRAM may offer without also considering the volatility of revenues, reduction in sales, and increase in operating costs that may result from expanded conservation programs and conservation-oriented rates. The evidentiary record, as developed by both California American and DRA, supports that conclusion.

California American's WRAM proposal would provide for recovery of all the utility's authorized fixed costs through a monthly service charge and a quantity rate protected by a WRAM account. Exh. 7 (Stephenson/CAW), at 11. The WRAM account would track the difference between full recovery of authorized fixed costs and the amount actually recovered and

would provide for later recovery of that difference. *Id.* at 12. California American's proposed MCBA is intended to track the difference between per-unit purchased water and power costs embedded in rates and those costs actually incurred by the utility. *Id.* at 34.

California American urged approval of these tracking proposals as means of reducing its long-term exposure to increased financial risk as a direct result of its corporate commitment to promoting conservation. Exh. 3 (Exh. A to App.), ch. 13, section 1, at 2. In practice, these mechanisms will tend to moderate variations between projected and actual revenues and costs to the benefit of both the utilities and their customers. Some variable and fixed costs will not be covered by either mechanism, so reduced consumption will continue to put the utility's cost recovery at risk to some extent.

DRA's witness likewise recognized that one purpose of a RAM is "to counter the perceived disincentive that utilities have to promote conservation," because successful conservation programs result in reduced sales that would lower revenues and earnings absent a RAM. Supplement to DRA Cost of Capital Report, dated June 22, 2006, at 3. Without a revenue adjustment mechanism, achieving conservation levels that exceed rate case projections will make it far more difficult for the utility to earn the return on its investment that the Commission has found to be fair and reasonable. In the face of the Water Action Plan's mandate to achieve conservation, this presents the water utility with a stark and serious financial risk.

It is unreasonable to impose a downward ROE adjustment based on adoption of a WRAM while not considering the increased risk imposed on the utility by a conservation-oriented rate design. This is especially true in the circumstances of the present California American GRC, where proposals for a reformed rate design and a WRAM are to be considered and potentially adopted concurrently in a further phase of this ongoing proceeding.

C. The PD Errs in Magnifying the ROE Reduction Based on the Assumption That Both a WRAM and an MCBA Will Be Authorized in Their Present Forms.

The PD is inconsistent and ambiguous in its consideration of the MCBA. At one point, the PD appears to recognize that different versions of an MCBA may have different impacts on risk and that the version of an MCBA that may be adopted in Phase 2 of the California American case is as yet unknown. The PD therefore claims to have based its ROE adjustment "primarily on the WRAM." PD, at 40. The PD nonetheless finds that the WRAM and MCBA together offer "substantial protection from weather and conservation uncertainties" – providing a reduction in business risk "much broader than the memorandum account protection we adopted in the Drought OII." PD, at 41. The 0.50% ROE reduction reflects this allegedly "broader" reduction in risk. *Id.* at 41.

It is not just the MCBA that is not fully defined. Both the MCBA and the WRAM, as proposed by California American and as criticized by DRA, are potentially subject to reevaluation and reworking in the upcoming Phase 2 of this California American GRC. Substantially different versions of both sorts of mechanisms have been proposed by other utilities in other applications. The place for evaluating the implications of all these mechanisms for the utilities' rates of return is the Water Conservation proceeding, I. 07-01-022.

The PD itself recognizes the need to develop a "track record of performance under the new mechanisms," observing that the Commission "may revisit the level of the ROE adjustment in later GRCs, when we have a track record of performance under the new mechanisms and also can look at the performance of the six comparable water companies we used in the DCF analysis here, especially if those companies do not have WRAMs and MCBAs." PD, at 3 n. 3. The Commission dealt with the ROE issue in similar terms when it authorized the SAM back in 1978, but at that time the Commission wisely deferred dictating an immediate adjustment to any

utility's ROE. *See*, D.88835, *supra*, 1978 Cal. PUC Lexis 62, *14. The Commission should do the same today.

III.

THE COMMISSION SHOULD CONSIDER THE RELEVANCE OF CONSERVATION MEASURES, INCLUDING WRAM AND RATE DESIGN CHANGES, TO ROE IN OTHER PROCEEDINGS

The Commission's Water Action Plan, adopted December 15, 2005, and the more recent Water Conservation OII, have presented water utilities, their regulators, and other interested parties with a complex array of interrelated tasks. The Water Conservation proceeding is addressing several water utilities' differing proposals for conservation rate design and for revenue adjustment mechanisms such as California American's WRAM. That proceeding is the proper venue to consider the combined effects of the individual utilities' particular conservation initiatives and revenue adjustment mechanisms on their financial risk and on generic ROE policy.

In the Water Conservation OII, the Commission specifically recognized the nexus between conservation rate design and WRAM as they may affect the utilities' required ROE – and posing the following question: ***Should the utilities' required return on equity be adjusted if a WRAM is adopted?*** – as one of the issues presented by implementation of increasing block rates. I.07-01-022, *supra*, at 8.

This is an issue the Commission has assigned for consideration in the Water Conservation proceeding. Commissioner Bohn, the Assigned Commissioner for that investigation, has directed that conservation rate design issues for California American, presented in California American's recently filed GRC proceedings, A.07-01-036 through A.07-01-039, should be coordinated with I.07-01-022. *See*, Assigned Commissioner's Ruling and Scoping Memo, issued March 8, 2007, in I.07-01-022, at 7. It makes no sense for the

Commission to prejudge the answer to the Conservation OII's question in a GRC decision that precedes even knowing the specific form of WRAM (or MCBA) that may eventually be approved for California American.

The issue presented in the Water Conservation OII is a general policy issue, posing the question whether adoption of a WRAM warrants adjusting the utilities' ROE. If the Commission's answer to that policy question turns out to be "yes," then the proper venue for considering the amount of any ROE adjustment will be the company-specific applications in the consolidated Cost of Capital proceedings, set for 2008 and 2009, and associated with the water utilities' rate case plan, as recently modified. *See, Rulemaking to Consider Revisions to the General Rate Case Plan For Class A Water Companies*, D.07-05-062, adopted May 24, 2007. It is appropriate that these Cost of Capital proceedings review each utility's ROE in the context of ***all*** the changes being implemented for that utility pursuant to the Water Conservation OII. This is just as true for California American as for any of the other Class A water utilities.

As indicated above, the utilities' Cost of Capital proceedings appear to be the best venue for addressing the implications for water utilities' ROEs of the adoption of conservation promoting measures in the Water Conservation proceeding. The Commission need not finally resolve that procedural issue at this time. All that is needed for now is to revise the pending PD to defer resolution this issue in the current California American GRC.

IV.
CONCLUSION

For all the reasons presented above, California Water Association respectfully urges the Commission to modify the Proposed Decision of ALJ Walwyn by eliminating the pre-determination that a downward Return on Equity adjustment of a particular amount should be made in the event that a WRAM and an MCBA are adopted for California American in the next phase of this proceeding. Accordingly, CWA respectfully proposes a substitute form of Finding of Fact 17 and a substitute form of Conclusion of Law 7 and further proposes the elimination of Ordering Paragraph 5 and the renumbering of Ordering Paragraphs 6 and 7, all as presented in detail in the attached Appendix A to these comments.

Respectfully submitted,

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APPENDIX A

PROPOSED FINDINGS OF FACT AND CONCLUSIONS OF LAW

Findings of Fact

17. The adoption of a WRAM and / or MCBA in Phase 2, in conjunction with conservation-oriented rate design changes, ~~might affect~~ is a significant element of and consideration in Cal-Am's business ~~risk~~ profile and that ~~effect~~ element ~~would~~ is ~~be~~ one of many factors relevant to a future determination of ROE for Cal-Am.

Conclusions of Law

7. Our case law for energy and water utilities reflects that the Commission has consistently held that the ~~implementation~~ consideration of a revenue adjustment mechanism is relevant to the determination of ROE in future Cost of Capital proceedings.

ORDER

5. . . .

6. . . .

CERTIFICATE OF SERVICE

I, Jeannie Wong, hereby certify that on this date I will serve the foregoing MOTION OF CALIFORNIA WATER ASSOCIATION FOR PARTY STATUS by electronic mail, on the following parties to A.06-01-005:

By electronic mail:

tkim@rwglaw.com; gkau@cityofinglewood.org; councilofficedistrict2@cityofinglewood.org; creisman@wkrklaw.com; krozell@wkrklaw.com; bmarticorena@rutan.com; uwua@redhabanero.com; dalderson@rwglaw.com; ndw@cpuc.ca.gov; Ldolqueist@steefel.com; ldolqueist@steefel.com; dstephen@amwater.com; rball@cao.lacounty.gov; sdlee3@pacbell.net; jmarkman@rwglaw.com; Pinkie.L.Nichols@KP.Org; jvasquez@cityofbradbury.org; lweiss@steefel.com; demorse@omsoft.com; darlene.clark@amwater.com; Martina@akwater.com; mrx@cpuc.ca.gov; cmw@cpuc.ca.gov; des@cpuc.ca.gov; dsb@cpuc.ca.gov; flc@cpuc.ca.gov; llk@cpuc.ca.gov; mkb@cpuc.ca.gov; nyg@cpuc.ca.gov; tfo@cpuc.ca.gov; ywc@cpuc.ca.gov

By hand delivery:

Hon. Christine M. Walwyn
Administrative Law Judge
California Public Utilities Commission
505 Van Ness Avenue, Room 5008
San Francisco, CA 94102-3214

Executed this 29th day of May, 2007 in San Francisco, California.

/S/ JEANNIE WONG
Jeannie Wong